No. 98-315

(4)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

AMERICAN RE-INSURANCE COMPANY
and NAC REINSURANCE CORPORATION,

Petitioners,

—v.—

JOHN P. CRAWFORD, INSURANCE COMMISSIONER OF THE STATE OF OKLAHOMA, AS RECEIVER OF EMPLOYERS NATIONAL INSURANCE CORPORATION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

Martha G. Bannerman
Ronald S. Gass
Of Counsel
NAC REINSURANCE CORP.
One Greenwich Plaza
Greenwich, Connecticut 06836
(203) 622-5200

John M. Nonna
Counsel of Record
Richard J. Cairns
Patricia A. Taylor
WERNER & KENNEDY
1633 Broadway, 46th Floor
New York, New York 10019
(212) 408-6900

Attorneys for Petitioners American Re-Insurance Company and NAC Reinsurance Corporation

25 pp

LIST OF PARENT COMPANIES AND NONWHOLLY OWNED SUBSIDIARIES OF PETITIONERS

1. American Re-Insurance Company (Munich American Reinsurance Company, an appellant in the Fifth Circuit was merged into American Re-Insurance Company):

   Parent Companies:

   Munich Reinsurance Company of Munich, Germany

   American Re Corporation

   Nonwholly Owned Subsidiary Companies:

   None

2. NAC Reinsurance Corporation:

   Parent Company:

   NAC Re Corporation

   Nonwholly Owned Subsidiary Companies:

   None

TABLE OF CONTENTS

Page

LIST OF PARENT COMPANIES AND NONWHOLLY OWNED SUBSIDIARIES OF PETITIONERS i

TABLE OF AUTHORITIES iii

I. THE FIFTH CIRCUIT'S DECISION CANNOT BE RECONCILED WITH DECISIONS OF OTHER CIRCUITS OR THIS COURT 2

II. THE FIFTH CIRCUIT'S INJUNCTION HOLDING CANNOT BE RECONCILED WITH DECISIONS OF THIS COURT AND OF THE EIGHTH AND FIRST CIRCUITS 7

CONCLUSION 10

APPENDIX:

A-- Petition to Compel Arbitration 1a

TABLE OF AUTHORITIES

Cases: **Page**

Bennett v. Liberty National Fire Insurance Co.,
968 F.2d 969 (9th Cir. 1992) 2, 4

Burger King Corp. v. Rudzewicz,
471 U.S. 462 (1985) 9

Davister Corp. v. United Republic Life
Insurance Co., 152 F.3d 1277 (10th Cir. 1998) 2, 6

Donovan v. Dallas, 377 U.S. 408 (1964) 9

Fragoso v. Lopez, 991 F.2d 878 (1st Cir. 1993) 4, 9
Garcia v. Island Program Designer, Inc.,
4 F.3d 57 (1st Cir. 1993) 5, 6

General Atomic Co. v. Felter, 434 U.S. 12 (1977) 9

Grode v. Mutual Fire, Marine & Inland
Insurance Co., 8 F.3d 953 (3d Cir. 1993) 3, 4

Group Life & Health Insurance Co. v.
Royal Drug Co., 440 U.S. 205 (1979) 5, 6

Hamilton Life Insurance Co. v. Republic National
Life Ins. Co., 408 F.2d 606 (2d Cir. 1969) 9

Page

Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) 9

Murff v. Professional Medical Insurance Co., 97 F.3d 289 (8th Cir. 1996) 4, 9

Penn General Casualty Co. v. Pennsylvania, 294 U.S. 189 (1930) 8

Quackenbush v. Allstate Insurance Co., 121 F.3d 1372 (9th Cir. 1997) 3, 4

Schaffer v. Heitner, 433 U.S. 186 (1977) 7, 8

United States v. Bank of New York & Trust Co., 296 U.S. 463 (1936) 8

Union Labor Life Insurance Co. v. Pireno, 458 U.S. 119 (1982) 5, 6

United States Department of the Treasury v. Fabe, 508 U.S. 491 (1993) 2, 5, 6

Statutes:

9 U.S.C.A. §§ 1-16 (West 1970) 2

15 U.S.C.A. § 1012(b) (West 1997) 2

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AMERICAN RE-INSURANCE COMPANY
and NAC REINSURANCE CORPORATION,

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v.

JOHN P. CRAWFORD, INSURANCE COMMISSIONER
OF THE STATE OF OKLAHOMA, AS RECEIVER OF
EMPLOYERS NATIONAL INSURANCE
CORPORATION,

Respondent.

REPLY BRIEF FOR PETITIONERS

Petitioners, American Re-Insurance Company and NAC Reinsurance Corporation, respectfully submit this Reply Brief to Respondent's Brief in Opposition to the Petition for Certiorari.

Respondent's opposition to the Petition advances arguments that do not address the conflict between the Fifth Circuit's decision and other courts. Resolution of the reverse preemption issue does not turn on which party commences the action. Moreover, a petition to compel arbitration is not an *in rem* or

quasi in rem proceeding. Respondent's opposition is contrary to *United States Department of the Treasury v. Fabe*, 508 U.S. 491 (1993). *Fabe* requires careful parsing of a state statute to determine if the statute was enacted for the purpose of protecting policyholders. Finally, the recent decision of a divided Tenth Circuit in *Davister Corp. v. United Republic Life Insurance Co.*, 152 F. 3d 1277 (10th Cir., 1998), illustrates how the Fifth Circuit's decision has caused confusion and misunderstanding in McCarran-Ferguson Act preemption jurisprudence.

I. THE FIFTH CIRCUIT'S DECISION CANNOT BE RECONCILED WITH DECISIONS OF OTHER CIRCUITS OR THIS COURT

Under the "impairment" prong of the McCarran-Ferguson Act, 15 U.S.C.A. § 1012(b) (West 1997), the Fifth Circuit held that the Federal Arbitration Act, 9 U.S.C.A. §§ 1-16 (West 1970) (the "FAA"), impairs state insurer insolvency laws because disputes that are arbitrable under the FAA are resolved outside the liquidation court. (Pet. App. 23a.)[1] In *Bennett v. Liberty National Fire Insurance Co.*, 968 F.2d 969 (9th Cir. 1992), however, the Ninth Circuit held the FAA did not impair orderly liquidation or interfere with state insurer insolvency laws, *see id.* at 972-73. The Ninth Circuit's holding in *Bennett* is squarely at odds with the Fifth Circuit's decision here.

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[1] References to "Opp. Br." are to Respondent's Brief in Opposition; "Reply Br. App." are to the Appendix to this Reply Brief; "Pet. App." are to the Appendix to the Petition for Writ of Certiorari.

Respondent's reliance (Opp. Br. at 7-8) upon dicta in *Grode v. Mutual Fire, Marine & Inland Insurance Co.*, 8 F.3d 953 (3d Cir. 1993), and *Quackenbush v. Allstate Insurance Co.*, 121 F.3d 1372 (9th Cir. 1997) ("*Quackenbush II*") to support his argument that those decisions do not conflict with the Fifth Circuit's because the liquidator commenced those actions, is misplaced. Respondent ignores the lack of any practical consequence or effect on the liquidation proceedings based on the "posture of the parties."

In *Bennett* and *Grode* the parties seeking arbitration removed an action brought by a liquidator to federal court and then moved to compel arbitration. The liquidators maintained that removal and invocation of federal court jurisdiction impaired the state insurance insolvency laws. There is no difference between seeking to compel arbitration in the first instance or doing so following removal. The effect on the state court's purported "exclusive jurisdiction" over delinquency proceedings is the same -- the proceeding is in federal court and the dispute submitted to arbitration if the petition is granted.

Moreover, the effect on policyholders is the same whether the liquidator is seeking to establish a debt owed by a third party or a third party is seeking to establish a debt owed by the insolvent insurer. In either case, the outcome of the action will affect the amount that creditors of the estate, including policyholder-creditors, will receive. The effect on policyholders is indirect in either case and no different from the effect on any other creditor. Importantly, whether a third party is seeking to liquidate a claim against the estate through arbitration or litigation, the priority statute is not impaired or

superseded; it still controls the order of distribution of estate assets.

Further, the "posture of the parties" was not the dispositive factor in either *Grode* or *Quackenbush II*. In *Grode*, the Third Circuit rejected the liquidator's McCarran-Ferguson Act argument as "totally irrelevant." *Grode*, 8 F.3d at 960. The court held that arbitration of the dispute would not interfere with the delinquency proceedings. *Id.* at 960-61. *Quackenbush II* also does not support Respondent's "posture of the parties" argument. The Ninth Circuit's suggestion that defendant Allstate might not be able to compel arbitration under the FAA of its set-off claims against the insolvent insurer, *Quackenbush II*, 121 F.3d at 1381, addressed an issue that was not before the court and which it did not decide.

As to the issue that was before the court in *Quackenbush II*, the Ninth Circuit reaffirmed *Bennett, id.* at 1381, and concluded that "the FAA imposes an absolute command on district courts to order arbitration for *all disputes* that are covered by a valid arbitration agreement." *Id.* at 1382 (emphasis added).

Further, because the alleged "impairment" of state insolvency laws results from submitting disputes to arbitration outside the liquidation court (*see* Pet. App. at 23a), *Murff v. Professional Medical Insurance Co.*, 97 F.3d 289 (8th Cir. 1996), and *Fragoso v. Lopez*, 991 F.2d 878 (1st Cir. 1993), rebut both the argument that there is no conflict between the circuits and the argument that the dispositive factor for the impairment prong is the posture of the parties.

In *Murff* and *Fragoso*, the parties sought a judgment against the insolvent insurer in federal court. Although the state liquidation statutes in those cases were, in all relevant respects, the same as the statutes here, the *Murff* and *Fragoso* courts rejected the contention that federal court actions would interfere with the state liquidation proceedings. Therefore, laws permitting federal court actions against the insolvent insurers did not conflict with the jurisdictional and injunction statutes in the respective insurer insolvency laws.

Futher, under the "state law enacted for the business of insurance" prong of the McCarran-Ferguson analysis, the Fifth Circuit's decision cannot be reconciled with *Garcia v. Island Program Designer, Inc.*, 4 F.3d 57 (1st Cir. 1993), or this Court's decisions in *Fabe*, 508 U.S. at 508-09 & n.8, *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119, 129 (1982), and *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205, 214 (1979).

Respondent attempts to reconcile the Fifth Circuit's holding that the Oklahoma jurisdictional and injunction statutes regulate the "business of insurance" with then-Judge Breyer's decision in *Garcia*, and this Court's decisions in *Fabe, Pireno,* and *Royal Drug,* by merely repeating the Fifth Circuit's statements that these laws benefit policyholders as well as other creditors. Respondent does not deny, however, that these statutes do not confer any greater benefit to policyholders than to other creditors. Moreover, Respondent appears to recognize that any benefit to policyholders from these statutes is both indirect (*see* Opp. Br. at 13-14) and speculative (*see id.* at 16, 17).

Considering these concessions, Respondent fails to reconcile these decisions with the Fifth Circuit's decision.

In *Garcia,* then-Judge Breyer concluded that a statute that provided policyholders with only an indirect, speculative benefit was too tenuous to trigger reverse preemption. *See Garcia,* 4 F.3d at 62. Likewise, in *Fabe* this Court held that state laws that provide indirect and speculative benefits to policyholders or that are not *necessary* for liquidation proceedings to begin, do not reverse-preempt federal law. *See Fabe*, 508 U.S. at 508-09 & n.8; *Royal Drug*, 440 U.S. at 214; *see also Pireno* 458 U.S. at 129 (listing three factors necessary for "business of insurance" test).

In *Davister Corp. v. United Republic Life Insurance Co.*, 152 F.3d 1277 (10th Cir. 1998), the Tenth Circuit followed the Fifth Circuit's decision here to create a new McCarran Ferguson Act doctrine of federal *abstention* on a petition to compel arbitration of a dispute arising under a real estate contract. *Id.* at 1278. As the dissenting opinion in *Davister* makes clear, the Fifth Circuit's decision cannot be reconciled with *Garcia, Fabe, Pireno* or *Royal Drug. See id.* at 1282 (dissenting opinion). *Davister's* new theory of federal abstention, which is based solely on the Fifth Circuit's decision, demonstrates that the latter decision will create confusion in McCarran-Ferguson jurisprudence and the law of abstention unless immediately reviewed by this Court.

II. THE FIFTH CIRCUIT'S INJUNCTION HOLDING CANNOT BE RECONCILED WITH DECISIONS OF THIS COURT AND OF THE EIGHTH AND FIRST CIRCUITS

The Fifth Circuit's holding that a state court acting under an insurer insolvency statute may enjoin *in personam* federal court proceedings (*see* Pet. App. at 24a-26a), squarely conflicts with the Eighth Circuit's decision in *Murff* and the First Circuit's decision in *Fragoso,* notwithstanding Respondent's suggestion to the contrary. Moreover, Respondent's claim that the decisions do not conflict because the federal court proceeding and arbitration were *quasi in rem* actions, is fundamentally flawed.

Contrary to Respondent's suggestion, both the FAA petition and the arbitration in Texas are *in personam* proceedings, making any court-confirmed arbitration award in Petitioners' favor an *in personam* judgment. The terms *in personam, in rem* and *quasi in rem* describe a court's basis for exercising jurisdiction over a defendant. Where, as here, a court's jurisdiction is based on its power over the "person" of a defendant, the judgment and action are *in personam*. *Schaffer v. Heitner*, 433 U.S. 186, 199 (1977). As this Court noted in *Schaffer*:

> If a court's jurisdiction is based on its authority over the defendant's person the action and judgment are denominated "in personam" and can impose a personal obligation on the defendant in favor of the plaintiff. If jurisdiction is based on the court's power over property

> within its territory, the action is called "in rem" or "quasi in rem." The effect of a judgment in such a case is limited to the property that supports jurisdiction and does not impose a personal liability on the property owner, since he is not before the court.

Id. Here, the jurisdictional basis for the federal court's and the arbitrators' power to adjudicate the dispute is their power over the insolvent insurer's "person." (*See* Reply Br. App. 2a-3a.) In contrast, the jurisdictional basis in *quasi in rem* actions such as *Schaffer v. Heitner, United States v. Bank of New York & Trust Co.*, 296 U.S. 463 (1936), and *Penn General Casualty Co. v. Pennsylvania*, 294 U.S. 189 (1930), is the location of property within the territory and control of the forum court. In *Schaffer v. Heitner,* a Delaware court asserted jurisdiction over out-of-state defendants "by sequestering" property located in Delaware. *See Schaffer*, 433 U.S. at 189. Likewise, in *Bank of New York*, jurisdiction over a Russian company was based on the forum court's "control" over that company's property. *See Bank of New York*, 296 U.S. 477. In *Penn General*, both the federal and state courts in Pennsylvania asserted *in rem* jurisdiction over the property of an insolvent insurer in liquidation proceedings. *See Penn General*, 294 U.S. at 194.

Here, there has been no attachment, garnishment, or other assertion of the federal court's power over any property in Texas (*see generally*, Reply Br. App.), and neither the Texas federal court nor the arbitrators could assert control over money

or property in another state.[2] Rather, the district court's power to adjudicate the petition to compel arbitration -- and the arbitrators' power to adjudicate the dispute -- is derived from their power over the insolvent insurer's "person" by virtue of reinsurance agreements that were executed in Texas and which contain written agreements to arbitrate disputes arising under those agreements in Texas under Texas law. (Reply Br. App. 3a, 6a-7a ¶¶ 5, 16-20; Pet. App. 41a, 46a-47a). The making of an agreement providing for arbitration in a particular state confers *in personam* jurisdiction on courts in that state. *Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co.*, 408 F.2d 606, 613 (2d Cir. 1969). *Cf. Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 481-82 (1985) (choice of law provision can be considered in determining whether the court has *in personam* jurisdiction over a defendant). For the same reason, the arbitrators' jurisdiction is *in personam.*

Accordingly, contrary to Respondent's contention, the Fifth Circuit's decision that a state court may enjoin *in personam* actions in federal court, cannot be reconciled with the First Circuit's decision in *Fragoso,* 991 F.2d at 880, the Eighth Circuit's decision in *Murff*, 97 F.3d at 290, or this Court's prior rulings, *see Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 21 n. 24 (1983); *Donovan v. Dallas*, 377 U.S. 408, 413 (1964); *General Atomic Co. v. Felter*, 434 U.S. 12, 18-19 (1977).

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[2] Further, in determining a debt, the arbitrators will decide Petitioners' contractual, not equitable, rights. Accordingly, there would be no "use of equitable remedies" to circumvent the priority statute.

CONCLUSION

For the foregoing reasons, and as set forth more fully in the Petition for Writ of Certiorari, this Court should grant the Petition for the Writ of Certiorari.

Respectfully submitted,

Martha G. Bannerman
Ronald S. Gass
Of Counsel
NAC REINSURANCE CORP.
One Greenwich Plaza
Greenwich, Connecticut 06836
(203) 622-5200

John M. Nonna
Counsel of Record
Richard J. Cairns
Patricia A. Taylor
WERNER & KENNEDY
1633 Broadway, 46th Fl.
New York, New York 10019
(212) 408-6900

Attorneys for Petitioners American Re-Insurance Company and NAC Reinsurance Corporation

APPENDIX

APPENDIX A

Petition to Compel Arbitration

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In the Matter of the Arbitration Between

MUNICH AMERICAN REINSURANCE COMPANY, and NAC REINSURANCE CORPORATION,

Petitioners,

JOHN R. CRAWFORD, INSURANCE COMMISSIONER OF THE STATE OF OKLAHOMA, AS RECEIVER OF EMPLOYERS NATIONAL INSURANCE CORPORATION,

Respondent.

PETITION TO COMPEL ARBITRATION UNDER THE FEDERAL ARBITRATION ACT AND FOR PRELIMINARY INJUNCTION PENDING ARBITRATION

COMES NOW, MUNICH AMERICAN REINSURANCE COMPANY ("Munich American") and NAC REINSURANCE CORPORATION ("NAC Re"), formerly known as North American Company for Property and Casualty Insurance,

Petitioners in the above-styled and numbered cause, seeking (1) an Order under section four of the Federal Arbitration Act, 9 U.S.C. § 4, compelling arbitration of their disputes with the Respondent, JOHN R. CRAWFORD, INSURANCE COMMISSIONER OF OKLAHOMA, AS THE RECEIVER OF EMPLOYERS NATIONAL INSURANCE CORPORATION and (2) a preliminary injunction under Rule 65 of the Federal Rules of Civil Procedure to maintain the status quo pending arbitration and award:

PARTIES

1. Munich American is a corporation duly organized and existing under the laws of the State of New York, with its principal place of business in New York.

2. NAC Re is a corporation duly organized and existing under the laws of the State of New York, with its principal place of business in Connecticut.

3. Respondent John R. Crawford ("Receiver"), the Insurance Commissioner of the State of Oklahoma, is the Receiver of Employers National Insurance Corporation ("ENIC") in Receivership. ENIC is a corporation duly organized and existing under the laws of the State of Oklahoma, with its principal place of business in Oklahoma.

JURISDICTION

4. Jurisdiction is based upon diversity of citizenship of the parties under 28 U.S.C. § 1332(a)(1) in that the matter in

controversy exceeds the sum of $50,000, exclusive of interest and costs, and is between citizens of different States.

VENUE

5. Venue is proper in the United States District Court for the Northern District of Texas, Dallas Division, under the forum selection clauses in the reinsurance agreements out of which these disputes arise, by which the parties have chosen to arbitrate any disputes arising thereunder in Dallas, Texas.

BACKGROUND

6. Pursuant to Umbrella Liability Reinsurance Agreement CAF 4139 ("MARC Agreement") between Munich American and Employers Casualty Company (including subsidiaries)(collectively the "Company"), effective January 1, 1986, Munich American agreed to pay to the Company a certain percentage share of the amount of net loss allocable under each Umbrella policy covered by the MARC Agreement. (A copy of the MARC Agreement is annexed as Exhibit A).

7. Pursuant to an Umbrella Liability Reinsurance Agreement ("NAC Re Agreement") between North American Company for Property and Casualty Insurance, now NAC Re, and Employers Casualty Company (including subsidiaries) (collectively the "Company"), effective January 1, 1986, NAC Re agreed to pay to the Company a certain percentage share of the amount of net loss allocable under each Umbrella policy covered by the NAC Re Agreement. (A copy of the NAC Re Agreement is annexed as Exhibit B).

8. Under the MARC Agreement and the NAC Re Agreement (collectively, the "reinsurance agreements") "net loss" means, "all payments by the Company in settlement of claims or losses . . . after deduction of salvage . . . ." (See Exs. A and B at Article IV(A)). "Salvage" is defined in the respective reinsurance agreements as follows:

> Salvage - This term shall mean any recovery made by the Company in connection with a claim or loss, less all expenses paid by the Company, other than payments to any salaried employee of the Company making such recovery.

(Exs. A and B at Article IV(C)). The agreements also provide for subsequent adjustments in net loss and payment of any amounts due either party:

> Upon receipt of a definite statement of net loss from the Company, the Reinsurer shall promptly pay to the Company the Reinsurer's portion of net loss and the Reinsurer's portion of adjustment expense, if any. Any subsequent changes in the amount of net loss shall be reported by the Company to the Reinsurer and the amount due either party shall be remitted promptly.

(Exs. A and B at Article XII(A)).

9. ENIC is a subsidiary of Employers Casualty Company and is a reinsured under the reinsurance agreements.

10. In 1991, Jobs Building Services, Inc. ("JOBS") settled a wrongful death claim requiring ENIC to pay $2,065,000 under an umbrella policy. Pursuant to their respective reinsurance agreements, Munich American paid $829,250, plus expenses, and NAC Re paid $829,250, plus expenses, as their respective shares of ENIC's net loss.

11. Subsequent to payment by Munich American and NAC Re, ENIC commenced an action against General Accident Insurance Company ("General"), the underlying insurer on the JOBS claim seeking damages due to General's improper handling of the claim. In 1994, ENIC, then in receivership, obtained a judgment against General in the United States District Court for the Southern District of Texas. General unsuccessfully appealed the judgment and subsequently settled the case for $2,500,000.

12. In June 1995, the net settlement funds, in the amount of $1,500,000, were tendered to and accepted by the Receiver on behalf of ENIC. (A copy of an October 4, 1995 letter to NAC Re acknowledging receipt by ENIC in Receivership is annexed as Exhibit C).

Disputes Arising Out of Reinsurance Agreements

13. Munich American and NAC Re claim subrogation rights to these settlement funds because they constitute "salvage" recovered in connection with the JOBS claim for which Munich American and NAC Re have paid their respective shares under the reinsurance agreements.

14. Disputes have arisen between the Receiver and Munich American and NAC Re concerning Munich American's and NAC Re's claims to their shares of these settlement funds.

15. The Receiver refuses to tender to Munich American and NAC Re their respective shares of these settlement funds.

Petitioners Have Been Aggrieved by Receiver's Unequivocal Refusal to Arbitrate

16. Each of the reinsurance agreements contains an agreement to arbitrate disputes. Article XV, entitled "Arbitration," which is identical in both reinsurance agreements, provides in part:

> As a condition precendent (sic) to any right of action hereunder, any dispute arising out of this Agreement, as well as any differences concerning the validity of this Agreement, shall be submitted to the decision of a board of arbitration composed of two arbitrators and an umpire meeting in Dallas, unless otherwise agreed. The laws of the State of Texas shall govern the interpretation of this Agreement.

(See Exs. A and B at Article XV(A)).

17. On June 11, 1996, Munich American and NAC Re requested that the Receiver agree to submit these disputes to arbitration under the reinsurance agreements. (See Exhibit 1 to the Declarations of William J. Albinger, Jr. and Christopher F. Finneran annexed hereto as Exhibits D and E, respectively).

18. On June 21,1996, the Receiver, unequivocally refused to agree to submit this dispute to arbitration. (See Exs. D and E at Exhibit 2).

19. Munich American and NAC Re are bound by their reinsurance agreements to arbitrate this dispute with the Receiver. The reinsurance agreements prevent the parties from resolving this dispute in any other forum. Consequently, Munich American and NAC Re have been aggrieved by the Receiver's refusal to submit this dispute to arbitration.

20. Therefore, as set forth in the accompanying Memorandum of Law, Munich American and NAC Re are entitled, under section four of the Federal Arbitration Act, 9 U.S.C. § 4, to an Order compelling the Receiver to submit this dispute to a board of arbitration in Dallas, Texas in accordance with Article XV of the MARC and NAC Re reinsurance agreements.

Preserving the Status Quo

21. Upon information and belief, the Receiver has retained the settlement funds and has not as yet used or disposed of them in any manner. Munich and NAC Re have advised the Receiver that these settlement funds are not part of the ENIC insolvency estate, but as a matter of law are deemed to be held in trust by the Receiver for Munich and NAC Re as subrogees. However, the Receiver refuses to relinquish control of the settlement funds to Munich American and NAC Re.

22. Therefore, as the Receiver continues to withhold these settlement funds, Munich American and NAC Re continue to

suffer immediate harm. This harm is irreparable if the status quo is not preserved with respect to these funds. If the Receiver disposes of any part of these funds, Munich American's and NAC Re's remedy will be inadequate and the arbitration will become a hollow formality.

23. A preliminary injuntion to preserve the status quo pending arbitration will not harm the Receiver, and will serve the public interest in honoring contracts and furthering the policy of the Federal Arbitration Act.

24. No previous application has been made for the Order or relief sought herein.

WHEREFORE, PREMISES CONSIDERED, petitioners Munich American Reinsurance Company and NAC Reinsurance Corporation respectfully pray that this Court issue an Order compelling the Receiver to proceed with arbitration and a preliminarily injunction to preserve the status quo pending arbitration prohibiting the Receiver from using, encumbering, or otherwise disposing of the settlement funds of $1,500,000, and the interest earned thereon, pending the arbitration and award, and such other relief as the Court deems appropriate.

Dated: Dallas, Texas
July 18, 1996

Respectfully submitted,

/s/
JAMES H. MOODY III
State Bar No. 14307400

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STRASBURGER & PRICE, L.L.P.
901 Main Street, Suite 4300
Dallas, TX 75202
(214) 651-4300
(214) 651-4330 (Facsimile)

JOHN M. NONNA
RICHARD J. CAIRNS
(Pro Hac Vice Admission Pending)
Werner & Kennedy
1633 Broadway - 46th Flr
New York, New York 10019
(212) 408-6900
(212) 408-6950 (Facsimile)

Attorneys for Petitioners
Munich American Reinsurance
Company
NAC Reinsurance Corporation